ESG HANDBOOK

Sustainable Investing at
Montanaro
Asset Management

MONTANARO

Certified B Corporation

Introduction

Many asset managers claim that they have been "doing" sustainable investing for years. This area of the market is broad, however, and one asset manager's definition of sustainable investing may not be the same as another's.

Our ESG Handbook, which we first published in 2014, aims to explain what we mean by sustainable investing and everything that this incorporates, from ethical restrictions, the integration of ESG analysis, to impact investing and beyond.

It is our purpose to deliver strong and sustainable investment returns to our investors by investing responsibly in quoted Smaller Companies. It is an aim for Montanaro to be one of the leading sustainable asset managers, a challenge that keeps us on our toes.

Our approach, like that of our investors and the wider market, is continuing to evolve. As we improve and adapt, so we have updated this Handbook.

This edition has been published in May 2022, when many are worrying about the trajectory of financial markets. We set out why we think our sustainable approach to investing can help us to navigate the complex financial landscape in both the good times and the bad.

Our aim with this document is to tell you everything about our approach to Sustainable Investing:

- Who we are and how we invest
- Why we think our Ethical framework remains relevant today
- How we integrate ESG into our Quality Growth investment process
- Our approach to Impact Investing
- Why being Sustainable Investors is integral to our role as long-term shareholders

We hope that you find it informative.

Ed Heaven - Head of Sustainable Investment
May 2022

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About Montanaro

Montanaro Asset Management ("MAM" or "Montanaro") is an asset management company that specialises exclusively in the management of long-only Global, European and UK Small & MidCap equity portfolios. As of 31 December 2021, we managed assets of £5 billion.

History & ownership

MAM was founded in 1991 by Charles Montanaro to provide an institutional approach to investing in Small & MidCap quoted equities. Based on experience from earlier in his career, Charles believed that the Small & MidCap equity market was largely overlooked by investors. He therefore founded Montanaro: *"a company of independent analysts to do the research needed on quoted SmallCap in-house on behalf of leading institutions who were never likely to have the resources to do the necessary work themselves"*[1].

MAM remains true to this Smaller Companies heritage, although we have expanded our geographic remit over the last 30 years. During the 1990s, MAM invested exclusively in UK equities; in the 2000s we began investing in companies listed in Continental Europe; and in 2018 we launched our first Global fund.

We introduced our first ethical exclusions in the 1990s, ESG was fully integrated into our investment process from 2005 (when we were awarded a mandate by the Church of England) and in 2018 we launched our first Global Positive Impact Fund, the Montanaro Better World Fund. In 2019 we won our first Impact mandate from a large Nordic Public Pension Fund. This was followed by the launch of a UK onshore version of our Better World Fund in 2020. Today we manage over £1 billion in Global Impact products. Our ethical framework and ESG analysis are applied to 100% of our assets.

B Corporation

In 2019, MAM placed sustainability at its core by becoming a certified B Corporation. This was achieved by meeting verified standards of social and environmental performance, transparency and accountability. In 2020, we amended our Articles of Association to place a legal obligation on the Board to consider the impact of Montanaro's business on its stakeholders. This formalised our business approach as one of "Stakeholder Capitalism" - moving beyond a "shareholder primacy" model to consider the impact of our organisation on all stakeholders, including people and planet. We will recertify for "B Corp" status in June 2022[2], a requirement of the three-year re-certification cycle.

Our investment approach

At MAM, all portfolios are managed according to the same "Quality Growth" investment philosophy.

We are stock pickers at heart: we construct portfolios purely on a bottom-up basis. We aim to identify the highest quality companies with the best management teams that we can hold for the long term. We

[1] *Montanaro Investment Newsletter, 2015*
[2] A summary of our B Corporation score is available here: https://www.bcorporation.net/en-us/find-a-b-corp/company/montanaro-asset-management/

believe that you "get what you pay for in life": it is worth paying more for a well-managed, financially sound business that operates in a growth industry and enjoys a sustainable competitive advantage. Businesses with such quality characteristics are able to "beat the fade" and maintain a high Return on Capital over the long term.

"Montanaro" companies share the following characteristics:

- Comprehensible business models;
- Profitable;
- Niche businesses in growth markets;
- Market leaders;
- High Operating Margins and high Returns on Capital;
- Outstanding management;
- Exemplary standards of ESG.

We take a conservative approach. We never lose sight of our primary goal which is to make money for our clients through sound investment decisions based on our own rigorous, fundamental analysis. We also believe that it is right and proper to align our interests with those of our investors – we all invest in our investment trusts and funds alongside our clients.

Sustainable investing

A sustainable focus is central to how we invest. We believe that the best and most sustainable investment returns come from the highest quality businesses, run by the very best management teams. ESG forms part of our definition of a company's Quality and ESG is fully integrated into our investment process. For a company to be deemed "Quality", it must meet the standards set out in our Ethical and ESG Policies, which are explained in detail in our ESG Handbook (available on our website[3]). We do not invest in companies that fail to meet our ESG standards or those that are unwilling to engage with us on areas of weakness. We believe this approach is well understood by our investee companies, providing us with good access to management when we need to engage, an approach endorsed by our clients.

We dedicate significant resource as we strive to achieve "best in class" status for our approach to sustainable investing and ESG. To support this effort, developments in 2021 included:

- ESG & Stewardship was added as a standing item at all MAM Board meetings.

- MAM became a signatory to the Net Zero Asset Managers Initiative ("NZAM").

- We became more active across the industry: we were the only UK investment boutique invited to join the Glasgow Financial Alliance for Net Zero ("GFANZ") taskforce. Our Head of Sustainable Investment sits on the Real Economy Transition Workstream.

- Our Head of Sustainable Investment was invited to co-chair the B Corporation Finance & Investment Working Group, a group of certified B Corporations in our industry working together on best practice initiatives. As part of this initiative, we led a group of investment boutiques to COP26 to discuss the benefits of being a B Corporation in the financial sector.

- We hired an ESG & Impact Specialist – a new position – to further support the work of our

[3] https://montanaro.co.uk/sustainable-investing/

Investment Team.

- MAM subscribed to MSCI's database of ESG company ratings, allowing us to compare our own internal analysis with a major ESG data provider.

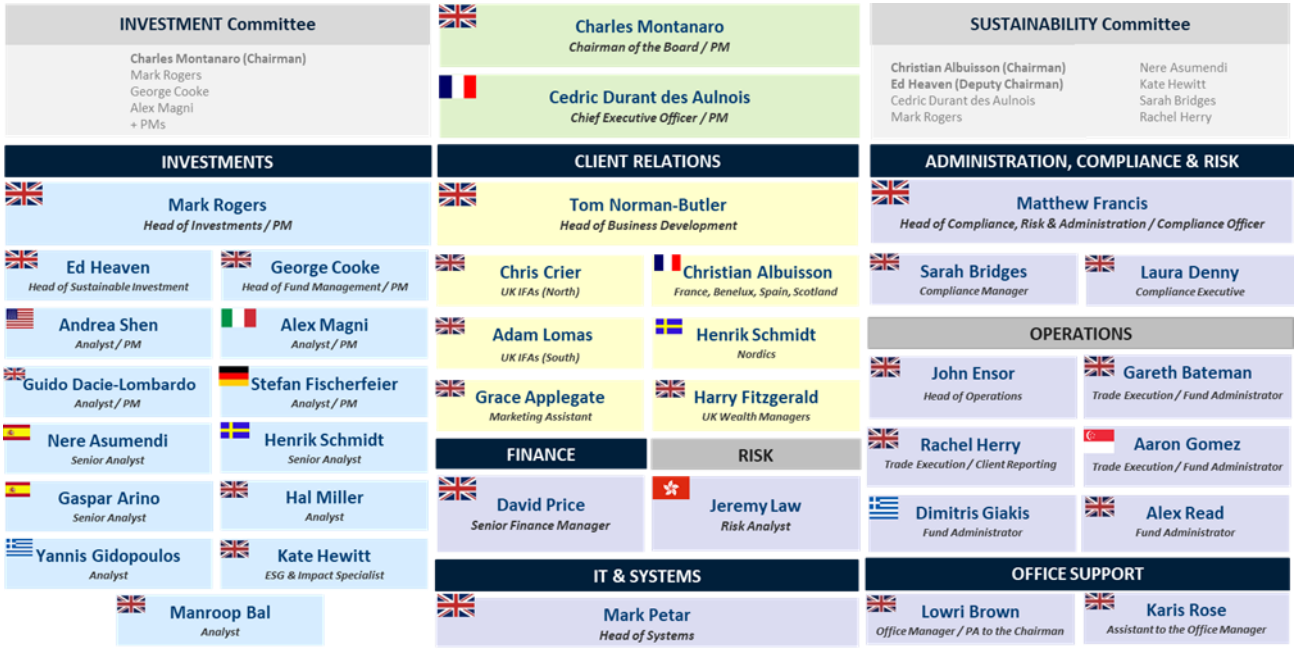
- We designed and rolled out a new, proprietary ESG Checklist which the Analysts complete as part of their due diligence work on companies.

Our team

With 36 people - including an investment team of 14 - Montanaro is one of the largest specialist teams in the world dedicated to Global Small & MidCap.

We have 8 Fund Managers, 4 of whom have Analyst responsibilities, in addition to 6 dedicated Analysts. This ensures that Research and Fund Management are inextricably linked to achieving attractive returns for our clients.

Embedded within our investment process is the analysis of ethical exposures and ESG factors, analysis that is the responsibility of our fundamental Analysts.



Our commitment to sustainable investing

ESG analysis is fully integrated into the investment process for all Montanaro Portfolios. Analysts at Montanaro are responsible for conducting fundamental research alongside ESG analysis. This helps us to build as complete a case as possible for the "Quality" of an investment.

To us, being Sustainable Investors means considering anything that may influence the long-term financial performance of our investments. Oversight is provided by our Sustainability Committee who formulate our ethical and ESG policies and ensure their consistent implementation across the house. ESG forms part of Analyst appraisals and is directly tied to remuneration.

Research (see appendix) supports our view that there is a positive correlation between how well a company manages issues in relation to ESG and what we are ultimately concerned with: the long-term return for our clients. We believe that this approach will help to foster a more sustainable form of capitalism.

We have a long-term investment horizon
We are genuine long-term investors, an increasing rarity these days. We still hold investments made in our first Fund launched in 1993, more than twenty years ago.

We are a truly Sustainable Business
We encourage our colleagues to live sustainably at Montanaro and in the world beyond. In recent years we have launched a number of sustainability initiatives: we have policies to reduce energy use and waste; we offset our carbon footprint; and we are active in the community via charitable work and donations.

Our sustainable focus became embedded within the legal framework of our company when we became a certified "B Corporation" in 2019. Montanaro is also a PRI signatory since 2009 and has been awarded the "Label ISR" (SRI label) by the French Ministry of Finance for two of our investment strategies. We have been signatories to the UK Stewardship Code since inception and were included in the first approved wave of signatories to the updated 2020 version of the Code.

Sustainability is part of our investment DNA
Sustainability forms an integral part of how we think, behave and invest. ESG was first included in our investment process over 15 years ago and today is firmly integrated within our approach. Every Analyst at Montanaro is responsible for conducting ESG and impact analysis on the companies under their coverage. The result is that our investment decision makers "do" sustainability analysis.

We conduct fundamental company analysis
At Montanaro, all research is conducted in-house. This has allowed us to integrate ESG into our investment process. We recognise that this is resource and time consuming, especially in SmallCap where managers cannot rely on external ESG research. It is one reason why we have the largest team of SmallCap Analysts in Europe. It is also why our Analysts are capable of not just assessing a company's finances, but also the more qualitative aspects of a business.

We seek to engage with our investee companies
As fiduciaries of our clients' assets, we take our shareholder responsibilities seriously. Through regular interaction with management teams we seek to promote high standards of ethics, an awareness of

environmental and social issues and transparent corporate governance practices. We have an active policy of proxy voting and a track record of seeking to improve companies through engagement rather than exclusion.

We take a stance on ethical issues

There are some companies that we will not consider engaging in. Typically, this is where they are involved in operations that we deem ethically detrimental to wider society. Our stance in these areas forms part of our commitment to our fellow stakeholders and helps to foster a longer-term perspective in the asset management industry.

Major public commitments:

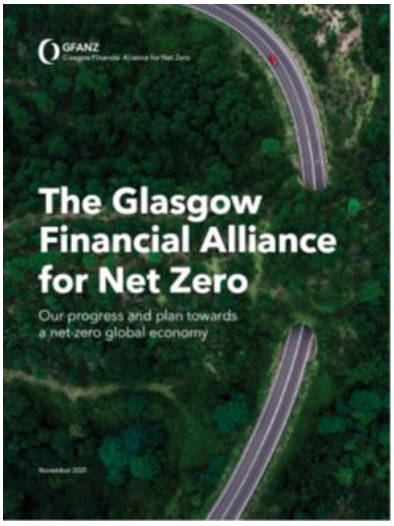
MAM's PUBLIC COMMITMENTS

Signatory of: PRI Principles for Responsible Investment	CDP DISCLOSURE INSIGHT ACTION	LGPS Advisory Board Code of Transparency
PRI 2009	**CDP** 2015	**LGPS Code of Transparency** 2017
Certified B Corporation — This company meets the highest standards of social and environmental impact	NET ZERO ASSET MANAGERS INITIATIVE	Signatory of: UK STEWARDSHIP CODE | 2021
B Corporation 2019	**NZAM** 2021	**UK Stewardship Code** 2021

Sustainability awards:

2019: Winner of **"Best Impact Fund"** Award (Investment Week)	**2022:** Winner of the **"Best Equity Global Small & MidCap Fund"** over 3 years (Lipper Europe) – Better World Fund
2019: Winner of **"Best Impact Report"** Award (Pensions for Purpose)	**2022:** Winner of **"Best Responsible Alpha Manager"** Award (FE fundinfo)
2020: Highly Commended for **"Best Impact Fund"** Award (Investment Week)	**2022:** Winner of **"Best Small & MidCap Sustainable Investment Boutique"** Award (Ethical Finance)
2021: Winner of **"Best Impact Equity Fund"** Award (Investment Week)	**Awards**

Montanaro at COP 26 & Co-Chairing B Corp Finance & Investment Working Group



Montanaro contributed to COP26 both as a member of GFANZ and our chairing of the B Corp Finance & Investment Working Group. We have been one of the few boutiques to have contributed to the work of the GFANZ taskforce. Specifically, we are part of workstream three, which focuses on Real Economy Transition Plans. This work was included in GFANZ's inaugural Progress Report, published as the group's chair, Mark Carney, spoke at Finance Day at COP26.

This work is hugely relevant to a multi-year engagement deep dive that our investment team is working on: Project: Net Zero Carbon, an ambitious project aimed at encouraging our investee companies to achieve net zero as rapidly as possible. Data gaps and a lack of consistency in reporting are problems that every investor confronts. GFANZ is aiming to bring existing frameworks together: Assessing Low-Carbon Transition; SBTi; CDP; Climate Action 100+; TCFD; Transition Pathways Initiative; and suggest how companies can best utilise what already exists in the market. It is not about reinventing the wheel.

We are also art of the B Finance Coalition, which we have co-chaired alongside EQ Investors. This group of 11 finance firms made a significant call to action at COP26, asking finance firms to join them and amend their constitutional documents to align with broader stakeholder needs. As B Corporations, we have all done this and believe it leaves our businesses better placed to tackle the climate crisis. Whoever is on our Board will have to ensure that the business is being managed in a way that delivers social and environmental good, now and in the future.

Sustainable investment policies

Companies that we consider for investment must pass the criteria set out in the following policies. Each policy has a corresponding checklist which our Analysts complete during the research process. The Ethics and ESG criteria that we highlight below forms form an intrinsic part of Montanaro's assessment of a company's "Quality".

Ethical Policy – our Ethical Exclusions apply across the house

On ethical grounds, we do not invest in companies that are involved in any of the controversial activities listed below (MAM's "Banned List"). In practical terms, this means that we aim to invest in companies which have nil revenue exposure to these areas.

Following client questions about how our policy deals with companies with de minimis exposure to the activities listed on our banned list, we added a supplementary rule in 2021: the Sustainability Committee will also review the eligibility of any company that derives a significant portion (c.10%) of its revenue from activities related to those on the "banned list"[4].

MAM's ETHICAL "BANNED LIST"

We do not invest in companies directly involved in:

Fossil Fuels	Tobacco	Alcohol	Gambling
Pornography	High Interest Rate Lending	Weapons	Animal Testing

The Sustainability Committee also reviews the eligibility of any company that derives a significant portion (c.10%) of its revenue from activities related to the above activities.

Source: Internal.

[4] N.B: these exclusions are explained in greater detail in MAM's ESG Handbook: https://montanaro.co.uk/wp-content/uploads/MONTANARO-ESG-HANDBOOK-2022.pdf

MAM's Banned List

Fossil Fuels

- Exclusion of companies involved in the exploration and production of coal, oil and gas.
- Ban encompasses both onshore and offshore extraction.
- We also ban investment in fossil fuel refinement companies.

Tobacco

- Exclusion of companies involved in the production and distribution of tobacco products.
- Ban encompasses traditional products (e.g. cigarettes) and vaping and e-cigarette products.

Alcohol

- Exclusion of companies involved in the production and distribution of alcohol products.

Gambling

- Exclusion of companies that own or operate gambling facilities of any kind (e.g. casinos, racetracks, lottery operations, online gambling, spread betting).

Pornography

- Exclusion of companies that produce and distribute pornography.
- Ban encompasses magazines, newspapers, videos, films, websites and related software, as well as companies involved in the staging of live sex shows or the ownership of sex shops.

High Interest Rate Lending

- Exclusion of any business whose activity is the provision of home-collected credit ("doorstep lending"), unsecured short-term loans ("payday loans") or pawnbroker loans, directly or through owned-subsidiaries.
- Common indicators of exploitative lending are close to triple-digit Annual Percentage Rates; short loan term durations (less than 18 months); and no requirement for security.

Weapons

- Controversial/Indiscriminate weapons exclusions: of companies involved in the production or supply of indiscriminate weaponry (defined as nuclear weapons, anti-personnel mines, cluster munitions, chemical weapons or biological weapons), with no turnover threshold to be applied.
- Any company involved in the production, processing, supply or storage of weapons-grade nuclear fissile materials, with no turnover threshold to be applied.
- Any company involved in the provision of parts or services for anti-personnel mines, cluster munitions, chemical weapons or biological weapons, with no turnover threshold to be applied.
- Conventional weapons exclusion: Any company deriving more than 10% of its turnover from strategic military sales including conventional military platforms, whole military systems, weaponry or strategic military parts or services.
- Non-military firearms exclusion: Any company deriving more than 10% of its turnover from the production or sale of non-military firearms or ammunition, excepting companies specialising exclusively in products specifically designed for hunting or sporting purposes.
- Note: Under this policy Montanaro is permitted to invest in companies whose products are used to ensure the safety of military personnel (e.g. protective equipment such as helmets), although such companies must not have exposure to the areas banned above.

Animal Testing

- Exclusion of companies that conduct (either themselves or via outsourcing) animal testing for purposes other than for regulated healthcare research.
- Where animal testing is conducted for non-healthcare related purposes, it must be required by regulation and we expect companies to have a clear animal testing policy compliant with "The Three Rs":
  - Replacement: methods which avoid or replace the use of animals in research;
  - Reduction: use of methods that enable researchers to obtain comparable levels of information from fewer animals, or to obtain more information from the same number of animals;
  - Refinement: use of methods that alleviate or minimise potential pain, suffering or distress, and enhance animal welfare for the animals used.

Environmental Policy

Our Environmental Policy helps us to identify the highest quality companies by guiding us towards truly sustainable investment opportunities. The areas that we focus on are influenced by and support the UN Global Compact.

Via an internally designed Environmental Checklist, we assess and score companies out of 10 on their environmental profile. Our approach helps to drive more accurate risk analysis, helping us to invest in those businesses capable and willing to manage their environmental footprint in a changing world. We engage with companies on environmental issues to better understand their approach to environmental issues; improve areas of weakness; and encourage improved levels of data disclosure and reporting.

We consider specific areas of environmental exposure in our analysis:

- Environmental intensity: how much carbon, water and waste is produced/consumed by our companies?
- Stranded asset risk: how exposed are our companies to unanticipated or premature write-downs of assets due to climate change?
- Reporting: which companies are failing to report quality environmental data?
- Climate change: which of our companies have taken steps to materially reduce their carbon footprint?

We use MSCI and company sourced data to measure the environmental intensity of our companies across carbon, water and waste. Where available, we record the carbon intensity of companies across Scopes 1, 2 and 3 based on tonnes of carbon used per million US Dollars of sales generated. We do the same for water and waste. This allows us to compare the carbon intensity of companies across our Approved List as well as within a given sector or Portfolio.
In addition to the above, we also record two MSCI scores related to how well companies are managing the transition to a low carbon economy:

Low Carbon Transition Management: this indicator measures how well a company manages risk and opportunities related to the Low Carbon Transition. It combines Management assessments for the following key issues: Carbon Emission for all companies; Product Carbon Footprint; Financing Environmental Impact; Opportunities in Clean Tech; and Opportunities in Renewable Energy where available. Higher scores (on a scale of 0-10) indicate a greater capacity to manage risk.

Low Carbon Transition Score: this is a company level score that measures a company's level of alignment to the Low Carbon Transition. Companies with higher Low Carbon Transition scores (on a scale of 0 - 10) are more aligned with the Low Carbon Transition compared to the companies with lower scores.

We assess environmental management culture (in accordance with UN Global Compact Principles 7-9); supply chain management; and the extent to which a company's products/services are a positive influence on the environment. We also record whether a company's operations are certified by a national or global standard (e.g. ISO 14001).

Finally, we consider the quality of a company's environmental reporting and if they have a Net Zero Carbon target or other environmental targets in place.

Climate Change: Our views on the "Energy Transition"

Climate change is possibly the greatest challenge facing humanity. To ensure that climate change is kept within a manageable range, a shift in how we produce and consume energy is required. Different views exist on how this can be achieved and the role that investors can play.

There are those who believe that investors should divest from fossil fuel industries. The divest movement – which has been seen before in relation to sectors including tobacco and political movements such as apartheid South Africa – seeks to remove investor support for companies involved in the production and supply of fossil fuels. The aim of this is to drastically reduce, or halt, the amount of fossil fuels extracted from the earth. The scientific argument in favour of this is that between two-thirds and four-fifths of fossil fuel reserves need to remain in the ground in order to limit global warming to a rise of 2°C compared to pre-industrial temperatures (these reserves are often referred to as being "stranded"). There is far more carbon lurking within existing fossil fuel reserves than can be safely burnt.

At the other end of the spectrum are those who believe that investors should continue to invest in fossil fuel related companies. The benefits fossil fuel production have brought to the world are often cited in support of this view: cheaper and more available energy has helped lift millions of people out of poverty, supporting globalisation and the raising of living standards. Turning off capital flows to fossil fuel industries could place this at risk given the Replacement Energy System – e.g. renewables – remains in its infancy. According to research by the energy consultant Lambert Energy Advisory, *"out of the 280 million barrels of oil equivalent energy (BOE) produced to keep…6 billion customers happy, only 7 million BOE will be 'new renewables'."*

Investors stepping into this debate must tread with care. Our aim is to support the shift to a cleaner energy mix as quickly as possible.

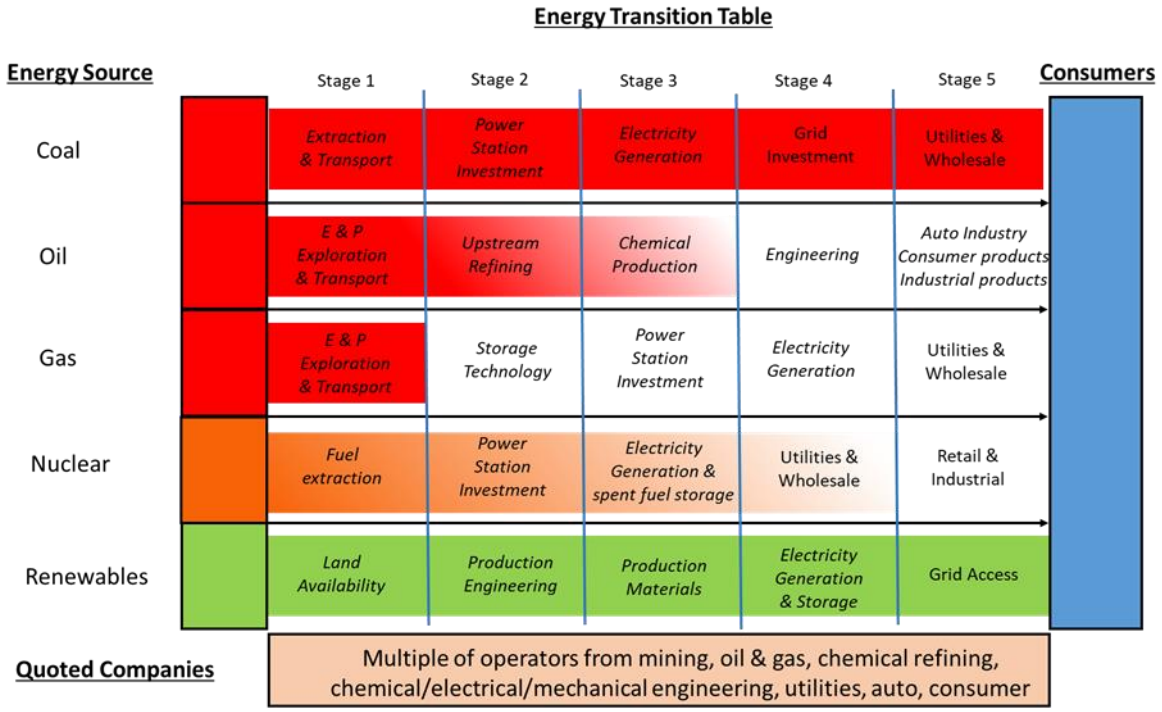
With this is mind, our stance can be summarised as follows:

1. We ban investments in oil, coal, and gas exploration & production companies;
2. To halt and reduce climate change, fossil fuels must be kept in the ground;
3. Despite the development of new technologies, the transition to a cleaner energy mix will take time;
4. For now, investing further down the energy value chain is permissible given the challenge of the energy transition;
5. Investment is needed in more efficient renewable energy storage technologies;
6. All companies have a role to play in the energy transition: we support companies who take steps

to reduce their own energy consumption and apply 100% renewable or Net Zero Energy targets, or Science Based Targeting;

7. Montanaro has a Net Zero Carbon target for its operations and is a signatory to the Net Zero Asset Managers Initiative, covering our portfolios;

We have developed an Energy Transition Table (below) to illustrate how we view different areas of energy production. This enables us assess where an energy company sits within the energy matrix.



As well as our exclusions of Exploration and production fossil fuels we also consider:

Nuclear:
High profile incidents such as Chernobyl and Fukushima have negatively impacted the public perception of nuclear power. Some countries, such as Germany, have stepped away from nuclear power altogether. While renewable energy has increased as part of Germany's energy mix, 40% of the country's electricity is generated from hard coal and lignite. The nuclear debate is one that we will continue to monitor. The energy produced is cleaner than fossil fuel energy, but clearly there are other challenges: if something goes wrong the consequences are potentially catastrophic, while the issue of radioactive waste disposal is yet to be settled. Another point to consider, particularly from an investment perspective, is the high cost of nuclear power plants, which makes a decent return on invested capital challenging.

Renewables:
The World Energy Council notes that "the rate of improvements towards cleaner energy is far slower than required to meet emissions targets". Solar and Wind currently account for just 8% of energy produced. Clearly renewable energy must take up a greater share of the global energy mix if climate change is to be stopped, or reversed. A steady transition is needed, however, so that the most sustainable and efficient technologies emerge. These must not rely on unsustainable subsidies and investors should carefully consider the investment risks of "concept" ideas that have yet to deliver a financial return. New technologies must be cleaner than fossil based alternatives across their value

chain, not just when they reach the consumer.

In addition to the above, we wish to encourage all of our investee companies to consider their energy consumption and what they can do to reduce their own carbon footprint. Companies that have a publicly stated "Net Zero Energy" goal should be applauded. Such targets can help the energy transition, allowing the "Carbon Budget" (the estimated amount of carbon we can use without breaching the 2°C limit) to be used by areas of the economy where it is most essential. With the carbon budget in mind, we encourage companies to sign up implement Science Based Targets. These can help investors to best contextualise a company's energy usage.

We also engage with companies to better understand and influence the steps they take in relation to their carbon emissions. We want to encourage our companies to aid the transition to a lower-carbon economy, hence in 2015, we became signatories of the Carbon Disclosure Project. We also encourage our companies to consider joining the RE100 club, a network of companies committed to 100% renewable power.

The focus on a business's environmental impact is only likely to increase over time: three of the ten UN Global Compact Principles are dedicated to the environment. These state that companies should *"support a precautionary approach to environmental challenges…promote greater environmental responsibility…and encourage the development…of environmentally friendly technology".* We encourage companies to continue improving their levels of environmental reporting.

Social Policy

Our Social Policy allows us to analyse specific social factors, leading to more accurate risk analysis of investment opportunities. The areas that we focus on are influenced by and support the UN Global Compact.

We engage with companies on social issues – by doing so, we believe that we can help to encourage management teams to contribute to a more sustainable world, which will ultimately lead to better investment returns.

We use MSCI, Bloomberg and company sourced data to measure and record the following in the Social Checklist:

- % Employee Turnover;
- % Women in Workforce;
- % Women in Management;
- Gender Pay Gap Breakout;
- Company 5-year tax rate;
- Underlying tax rate;
- Estimated Tax Gap;
- Social tax rating.

Additional areas that we focus on include: Human rights; Bribery & Corruption; Equal Opportunities; Labour Practices; Human Resources & Training; Supply chain management. Companies are scored out of 10 for their social profile on our Social Checklist.

Corporate Governance Policy

We want to align the interests of company management teams with the interests of long-term shareholders. Our Corporate Governance Policy helps us to identify companies with high standards of governance, while highlighting companies with areas of risk or weakness.

Our logic here is simple: good corporate governance increases the quality of a business – and the higher the quality of a business, the greater the sustainability of investment returns.

Via an internally designed Corporate Governance Checklist, we assess and score companies out of 10 on their governance profile.

The Corporate Governance Checklist considers:

- Remuneration of the Executive;
- Capital Allocation Record;
- Board Independence;
- Board Ownership;
- Board Diversity.

We engage with companies on governance issues and work with management teams to foster a responsible and long-term approach to the running of their companies.

Remuneration:
We consider the level of executive compensation, including base salary, bonuses and long-term incentives. In particular, we are interested in the structure of remuneration packages and the role of the Remuneration Committee. The right kinds of incentives can ensure that management are focused on what matters most for shareholders: creating sustainable shareholder value. As long-term investors, we want the interests of management to be aligned with ours. We expect management teams to behave ethically and responsibly in relation to pay, taking into account the impact excessive executive pay can have on other stakeholders.

Capital Allocation Record:
When we model a company's financials, we also analyse the capital allocation record of the management team. This tells us whether management have been deploying capital efficiently and effectively, thereby enhancing the long-term value of the business. To ascertain this, we analyse Return on Capital Employed (ROCE) relative to the cost of capital. Shareholder value is created when economic ROCE is sustained at a level above the cost of capital. We are specifically interested in what management are directing their capital towards. We consider the level of reinvestment in the business; the acquisition track record; the dividend policy; share buyback programs and the level of cash relative to debt.

Board Independence, Ownership & Diversity:
Companies should aim to have the right governance structure in place. In general, we look for Boards to have a majority of Non-Executive, fully independent Directors. We recognise, however, that this may not always be possible or warranted in the case of small companies. An executive founder, or a family, may retain a material interest in the business and a significant presence on the Board. Therefore, we consider the suitability of Boards on a case-by-case basis, taking into account Director tenure, skills and reputation. We expect companies to disclose sufficient biographical information about Directors to enable investors to make a reasonable assessment of the value they add to the company. We want to

see our investee companies achieve Board independence over time.

Voting:
Voting is a vital part of our engagement with companies which is why we vote at all AGMs. We receive independent third party corporate governance reports and voting recommendations from Institutional Investor Services (ISS) ahead of meetings. These are used for advice only. Our Analysts systematically review all resolutions ahead of shareholder meetings and we voice our concerns where required. We aim to discuss any issues with management prior to voting against or abstaining. As such, we consider ourselves as "active" shareholders rather than "activists".

Sustainability Committee

Our Sustainability Committee is made up of experienced members from across our business. The Sustainability Committee meets officially on a quarterly basis.

The Sustainability Committee has three main functions:

1. Ensure that Montanaro's ESG and sustainable investment approach remains fully integrated into our investment process and continues to develop and improve;

2. Review the ESG and impact analysis conducted by MAM's Investment Team, and review engagement and voting activity.

3. Oversee MAM's corporate stewardship responsibilities, such as our responsibilities as a B Corporation.

The Committee meets on a quarterly basis and is comprised of members who collectively have many years of sustainable investment experience. Meetings have a formal agenda and minutes are taken, which are available to clients upon request. To ensure that there is buy-in across the organisation, the Committee is formed of members from the Investment, Client Relations and Compliance teams.

Agenda items include:

- Review of previous minutes and action points;
- Review of voting activity;
- Review of engagement activity;
- Review of impact voting log;
- Sustainability topics highlighted for discussion;
- ESG & Research;
- Seminars, events and press contributions during the quarter;
- Sustainability at Montanaro;
- Any other business;
- Ethics (annual item).

In 2021, we formed an internal "Net Zero Steering Group"[5] to oversee and guide our transition pathway. Responsibilities include working with environmental consultant Green Element to measure MAM's carbon footprint; the setting of interim targets; and the appraisal of different mechanisms in the market (such as carbon offset options) that may support us on our transition pathway.

The Steering Group also has responsibility for MAM's commitments under the Net Zero Asset Managers initiative and work took place to prepare our methodology for submission in 2022.

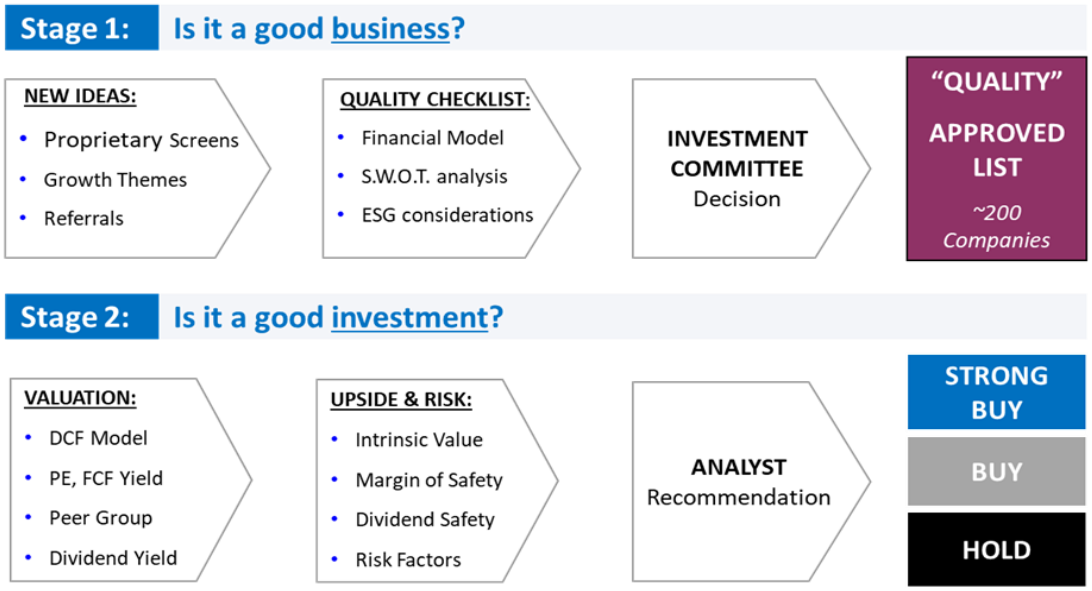
[5] The Net Zero Steering Group is sub-set of our Sustainability Committee

Sustainability in the investment process

ESG analysis is fully integrated into the Montanaro investment process. This analysis is conducted by our Investment Team, meaning that our decision makers "do" ESG.

The following investment process is applicable to all Montanaro Funds, although the Better World Fund has an additional "impact" stage which is explained in the Impact section of this handbook.

ESG integration:
Our investment process has two distinct stages.



The first stage focuses on identifying High Quality companies. In essence, we aim to answer the question: "Is it a good business?". ESG forms part of our definition of a company's "Quality". We do not believe it is possible for a company to be deemed Quality if it is exposed to material ESG risks, or management do not pay due attention to material ESG factors.

Using our bespoke ESG Checklists, Analysts appraise the ESG profile of our companies. As explained above, checklist covers Ethics, Environmental, Social and Corporate Governance in turn. Scores for each ESG area weighted and then aggregated to produce a final ESG score out of 10. We weight Corporate Governance section of our checklist higher than Environmental and Social as we believe management are ultimately responsible for a company's approach to ESG. An example summary section of an ESG Checklist is shown below:

MONTANARO ETHICS & ESG CHECKLISTS

SUMMARY

	Score	% Weight	General Comment / Key Issues
ETHICS	Pass	/	The company has a very poor score on its Environmental Checklist. The company publishes very little data on its environmental footprint and does not publicly disclose its approach to environmental matters. We need to arrange an engagement with management to understand why disclosure in this area is so poor.
ENVIRONMENTAL (1 to 10)	2.0	30%	
SOCIAL (1 to 10)	6.0	30%	
CORPORATE GOVERNANCE (1 to 10)	6.0	40%	
ESG Score (1 to 10)	**4.8**	**100%**	
ESG Rating	**REVIEW**		
Engagement Required?	**YES**		

Conclusions from our ESG analysis are presented to the Investment Committee who discuss any issues with the Analyst. The Committee will decide to continue with, or discard, a new idea based on the Analyst's findings. Companies with a total ESG score of below 5 are flagged on the Checklist under "Review" (as shown above) meaning that engagement is required if we wish to invest in the company.

To better understand our internally derived ESG scores, in 2021 we started to receive MSCI's ESG Ratings for companies in the MSCI World SMidCap Index. The purpose of this is to allow a comparison of our internal ESG score to a "market proxy" and understand any points of difference. For example, during the year a healthcare company that we had scored well was rated poorly by MSCI. After reading MSCI's analysis, we discovered that the company had been penalised for poor disclosure. We engaged with the company who told us that they had not completed the MSCI ESG Questionnaire due to internal resource pressures. This is not unusual for smaller companies, but we suggested that in the interests of improving their reporting, the company should complete this questionnaire going forwards.

Analysts continue to update the ESG Checklists throughout the holding period as new information comes to light, for example after a set of results; the AGM; or an engagement. The Sustainability Committee monitors the ESG scores of companies on our Approved List at quarterly meetings to understand how Analysts are scoring companies.

We aggregate company ESG scores across each of our investment portfolios to produce a total ESG Fund Score, which is visible on monthly factsheets for each of our Funds.

Our clients typically have long-term investment horizons (five years plus) and our approach to ESG reflects this long-term commitment. As a result, we are prepared to invest in a company with a weakness in its ESG profile so long as management express a willingness to engage with us and a desire to improve any areas of weakness. These checklists have led to engagements that have resulted in higher conviction in the investment case and also decisions to sell stocks, for example:

- **Increased conviction:** The Environmental reporting of a Swedish company we invested in was notably poor, with little detail given on Scope 1, 2 or 3 emissions. After engaging with the CEO of the company, we encouraged them to sign up to the Science Based Targets Initiative in support of the CDP Science Based Targets Campaign. The company has done so and delivered an improved Sustainability Report with a greater level of reported environmental data. This allowed our Analyst to increase the Environmental Checklist score and increased our confidence in the investment case.
- **Reduced conviction:** We spoke to a company listed in Hong Kong about their plans to transition to a less carbon intensive business model following the completion of the company's ESG Checklist. Management informed us that they were unlikely to set any environmentally linked

targets for their business as there is little incentive from the Chinese government for them to do so. Coupled with some concerns about the ownership structure that were flagged by the Analyst in the Corporate Governance Checklist, we decided to sell our holding.

Our ESG Checklists also help us to set ESG priorities. In particular, they allow us to identify risks common to many of our companies. When we identify such risks, our Head of Investments and Head of Sustainable Investment works with the team to explore the issue in greater detail via an engagement "Deep Dive".

The purpose of these Deep Dives is to engage with companies from across our Approved List and improve our understanding of a particular risk and the quality of our analysis. In recent years we have conducted engagement Deep Dives on:

- **Project Net Zero Carbon 2021**
- **Project Net Zero Carbon 2020**
- **Data Centres Project 2021**
- **The Biomass Debate 2020**
- **Plastics Fantastic: Biffa Site Visit 2021**
- **Supply Chain Investigation 2018**

Our Deep Dive reports are available on Montanaro's website. A detailed explanation of our ESG Policies and Checklists is contained within our ESG Handbook, which is also available on our website.

A full example of an ESG Checklist is shown below:

MONTANARO ETHICS & ESG CHECKLISTS

SUMMARY

	Score	% Weight	General Comment / Key Issues
ETHICS	Pass	/	Chr Hansen seems committed to responsible business practices as reflected by their comprehensive number of policies ranging from quality and product safety to people, knowledge and sourcing. However, despite awards and good initiatives for labour practices, disclosure could still be improved. Looking into integrating TCFD targets from next fiscal year, as they already report with another methodology.
ENVIRONMENTAL (1 to 10)	8.5	30%	
SOCIAL (1 to 10)	7.6	30%	
CORPORATE GOVERNANCE (1 to 10)	5.5	40%	
ESG Score (1 to 10)	**7.0**	**100%**	
ESG Rating	**PASS**		
Engagement Required?	**NO**		

ETHICS CHECKLIST — **Does the Co. meet MAM's minimum standards?** Pass

Business Exposure	**Pass / Fail** (fail any company with >10% of revenue exposed to restricted areas)	
Exploration & production fossil fuels	Pass	No major problems identified. Chr Hansen products are all natural: Cultures & Enzymes (improve taste, preservation, nutritional value..), Health & Nutrition (probiotics -documented, infant formula). Chr Hansen is committed to reducing annual global yogurt food waste by 2% by 2020 through bioprotection. Products also reduce salt from cheese (Saltlite up to 50%), sugar from yogurts, and replace antibiotics with probiotics. Ranked #1 most sustainable company in the world by Corporate Knights (last year #66). The one slight criticism received during an ESG committee is that a significant portion of products are used by the dairy industry (exposure to cows, which contribute to methane emissions).
Tobacco producers & distributors	Pass	
Alcohol producers & distributors	Pass	
Controversial weapons	Pass	
Gambling	Pass	
Pornography	Pass	
High Interest rate lending	Pass	
Animal testing (ex-healthcare related)	Pass	
Other areas of concern	No	

Environmental Checklist

Score: 8.5

6.80

Environmental Data	(Data from column AD)
Carbon Intensity Scope 1 (tonnes/USD million sales)	20.2
Carbon Intensity Scope 2 (tonnes/USD million sales)	18.4
Carbon Intensity Scope 3 (tonnes/USD million sales)	70.6
Carbon Intensity Scope 1+2+3 (tonnes/USD million sales)	109.2
Water Intensity (vs. sales) (m3 water/million sales)	
Waste Intensity (tonnes/USD million sales)	3.0
Low Carbon Transition Management (1 to 10)	5.3
Low Carbon Transition Score (1 to 10)	6.3

ISS rates it as a medium performer in terms of carbon risk rating. It rates above peers (14.8t) 2x in terms of scope 1 and 2.

Environmental Assessment	Yes/No	Level
Environmental management	Average	3
Climate change target	Good	4
Supply Chain Management	Average	3
Environmt. value add of product /service	Good	4
Quality of reporting	Good	4

They supply biological residues as natural fertilisers for farmers, and now it is also used for biogas production. Danish sites run on 100% renewable energy. Part of 'Business Ambition for 1.5°C' (Paris agreement).
Looking into adding TCFD targets next year.

Social Checklist

Score: 7.6

Social Data	(Data from column AD)
% Employee Turnover	10%
% Women in Workforce	43%
% Women in Management	
Gender Pay Gap Breakout	No
Human Rights Policy	Yes
Anti-Bribery Ethics Policy	Yes
Equal Opportunity Policy	Yes
Company 5-year tax rate [see model]	22.7%
Underlying tax rate [see model]	22.7%
Estimated Tax Gap	0.0%
Social tax rating	Average 3

In Chr Hansen's website, under the responsibility section, there are environmental sustainability, workplace responsibility and business integrity including a whistle-blower hotline and their position on corruption. The diacetyl lawsuits are ongoing but relate to the flavours division that was sold in 2012.
Tax is in line with Danish tax rate of 22%.

Social Assessment	Yes/No	Level
Labour Practices	Good	4
HR Management / Training	Average	3
Health & Safety (Accidents)	Good	4
Supply Chain Management	Average	3
Social value add of product / service	Very good	5
Other (Modern Slavery, stakeholders...)	Very good	5
Anti-bribery controls	Good	4
Quality of reporting	Average	3

Moved from a biannual to an annual employee engagement survey. Green pension solutions available in Denmark (half of workforce).
In 2019/20 Chr. Hansen received the Transformation Award Winner in the British Safety Council 2020 International Safety Award.

Key Social Issue

Diacetyl lawsuit

Chr Hansen is a defendant in several diacetyl related lawsuits relating to the period when products containing diacetyl were produced (flavours division that was sold) that allegedly caused personal injuries resulting from the exposure to diacetyl vapours. The company has insurance cover for losses from those claims. This will disappear following the sale of Natural Colors division.

Corporate Governance Checklist

Score: 5.5

8.2

Remuneration of Executive Board

Average 3

Measurement metric	Base Salary	Annual Bonus	LTIP
Strategic KPIs		Yes	Yes
Profit Share			
EVA/ROCE			
Relative TSR			Yes
EPS/Net Profit Growth		Yes	Yes
ESG			

According to ISS "The structure of the company's compensation framework does not raise any material concerns, as it generally appears to be designed to promote alignment between pay and performance. Although ex-post disclosure on performance targets is generally preferred, it is noted that the variable pay plans appear to be aligned with the company's strategy and guidance".
Short term Targets: FCF, EBIT before special items, organic growth and individual non financial targets. LTIP: EBIT before special items, organic growth, retention, relative TSR.

Overall level of pay	High

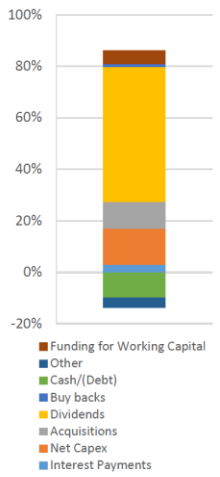
ISS: remuneration falls within one sample standard deviation of the ave

Capital Allocation Record

Very good 5

Metric	Year T-4	Year T-3	Year T-2	Year T-1	Year T	AVERAGE
ROACE	40%	41%	40%	37%	34%	**39%**
ROIC	15%	17%	17%	17%	17%	**16%**
Invested Capital growth	2%	18%	9%	3%	11%	**9%**
	T - 5 to T	T - 4 to T	T - 3 to T	T - 2 to T	T - 1 to T	
Return on Incremental Capital	25%	21%	23%	17%	14%	**20%**

Metric	Year T-4	Year T-3	Year T-2	Year T-1	Year T	Total
Cash Flow	192,000	215,800	266,800	285,700	277,700	**1,238,000**
% Allocated to:						
Interest Payments	6%	5%	4%	4%	4%	**4%**
Funding for Working Capital	4%	3%	9%	10%	9%	**7%**
Net Capex	13%	14%	20%	18%	30%	**19%**
Acquisitions	0%	78%	27%	0%	(24%)	**14%**
Dividends	96%	38%	72%	76%	81%	**73%**
Buy backs	16%	(8%)	(2%)	1%	2%	**1%**
Cash/(Debt)	(34%)	(30%)	(3%)	(9%)	(1%)	**-13%**
Other	0%	0%	(27%)	0%	(0%)	**-6%**



Board Independence & Ownership

Score: 8.5

(Data from column AD)

Chairman	Dominique Reiniche	
CEO	Mauricio Graber	
ESG Culture	Very good	5
CEO Duality		No
Board Size		11
% Non-Exec. Director on Board		100%
% Independ. Directors		64%
% Women on Board		36%
% Female Executives		22%
% Independ. Director in Compen. Com.		100%
Board Independence rating	Average	3
Board Diversity rating	Very good	5
Quality of reporting	Good	4

ISS: There are 2 boards: execs and non-exec. Here is the board of directors (12 non-execs), which has 4 employee and 1 shareholder representatives (Novo Nordisk hold 21.98% of capital). The BoD is 58% independent.

Impact investing

In 2018, we launched the Montanaro Better World Fund to invest globally in Small & MidCap companies whose products or services make a positive impact by helping to solve some of the world's greatest challenges in support of the UN Sustainable Development Goals.

The investment process for the Better World Fund is largely the same as for our other Funds in terms of the financial fundamentals and our analysis of ESG factors. However, there is an additional step that considers the impact of a company's products and services and whether they are positively aligned to six impact themes:

Analysts complete an "Impact Profile" for every company that we consider for investment. These reports allow us to assess how a company's products/services are helping to solve a major world problem, such as climate change or a healthcare challenge. Analysts attribute company revenue against the Fund's 6 themes and we will only invest in companies with revenue alignment of at least 50%. Members of our Sustainability Committee vote on whether a stock passes or fails for impact. Since launch the Sustainability Committee has failed 20% of the ideas it has been asked to consider.

In 2021, our Investment Team developed an "Impact Score", further developing our approach to impact investing and allowing us to better assess the spectrum of impact across the Portfolio. A company must have an impact score of at least 12.5 in order to pass our Impact Criteria.

An example of a company Impact Profile is shown on the next page.

COMPANY IMPACT PROFILE:	Terna Energy

Company description:

Terna Energy SA is a Greece-based company engaged in the renewable energy sector. The Company is actively involved in the construction and operation of wind farms, small hydroelectric plants and integrated process units for the overall management and energy utilisation of wastes and biomass. The Company is also active in the construction industry as a contractor in the private and public works sectors where it undertakes energy, industrial, building and other engineering projects.

IMPACT SCORE:	[Scale: 1- 10]	
Impact on People	High	6
Impact on Planet	High	8
Intentionality	High	7
Additionality	Neutral	5
Impact risk	Low	7
GROSS IMPACT SCORE		33
Thematic revenue		85%
Harmful revenue		0%
Net thematic revenue		85%
NET IMPACT SCORE (Max 50; Pass 12.5)	**PASS**	**28.1**

COMMENTS:

The development and operation of renewable energy facilities is has a positive impact on the planet. The range of projects operated by the company includes biomass which, although renewable, is not carbon neutral at the point of combustion. Hydroelectric plants can also have ecological and social consequences (depending on the research and community engagement undertaken prior to their installation) and so this must be taken into account when evaluating overall positive impact on planet (hence the proposed score of 8). The positive impact on people comes as a by-product of climate action and the creation of new roles as part of green economic development. Management measure their positive impact via carbon emissions avoided in their sustainability report, this indicates intentionality. Although no forward looking sustainability targets for operational efficiencies have been set. The additionality of the Terna services is limited as they are not unique and predominantly operate in the global north. Regarding Impact Risk, it seems likely that the key focus will remain on renewable power generation so the impact case is unlikely to change however the development of further biomass assets may jeopardise our view of their contribution to climate action and a donation was made in 2021 to

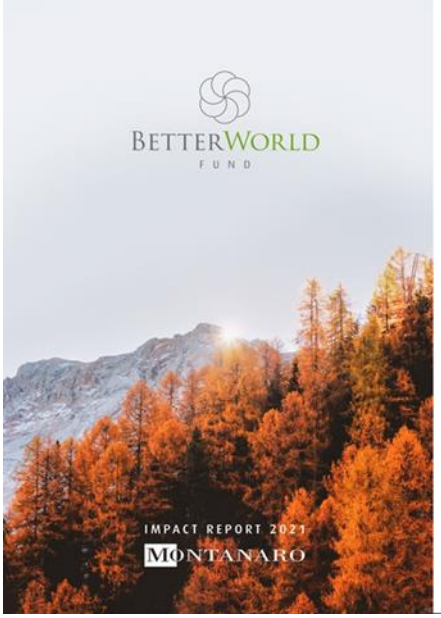
THEMATIC REVENUE		% of sales			% of sales
1	**Environmental Protection:**	**0%**	4	**Innovative Technologies:**	**0%**
	Pollution control	0%		Manufacturing efficiencies	0%
	Water treatment	0%		Smart robots & artificial intelligence	0%
	Waste recycling & management	0%		Connected world	0%
	Testing, inspection & certification	0%		Cybersecurity	0%
2	**Green Economy:**	**85%**	5	**Nutrition:**	**0%**
	Renewable energy	85%		Efficient food production	0%
	Smart infrastructure	0%		Sustainable distribution	0%
	Energy transition	0%		Healthy eating	0%
	Efficient transportation	0%		Food security	0%
3	**Healthcare:**	**0%**	6	**Well-being:**	**0%**
	Treatment of illnesses & disease	0%		Changing demographics	0%
	Medical innovation	0%		Active lifestyle	0%
	Affordable healthcare	0%		Education	0%
	Prevention	0%		Safety	0%
GROSS thematic revenue					85%
HARMFUL revenue					0%
NET thematic revenue					**85%**

UN Sustainable Development Goals - Alignment	
UN SDG:	**Goal 7. Ensure access to affordable, reliable, sustainable and modern energy for all**
TARGET:	*7.2 By 2030, increase substantially the share of renewable energy in the global energy mix*
INDICATOR:	*7.2.1 Renewable energy share in the total final energy consumption*

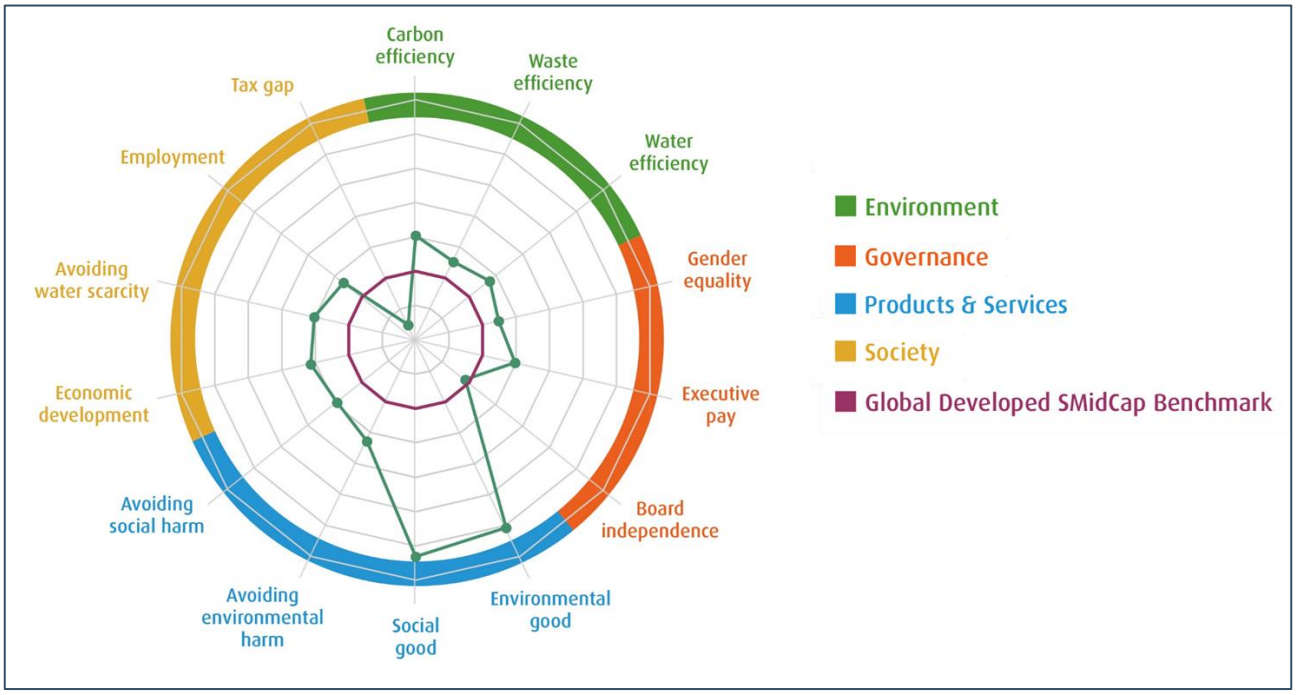
IMPACT MANAGEMENT PROJECT CLASSIFICATION	
Highlight one of the below:	
A	Act to avoid harm
B	Benefit stakeholders
C	Contribute to solutions

Annual Impact Report:

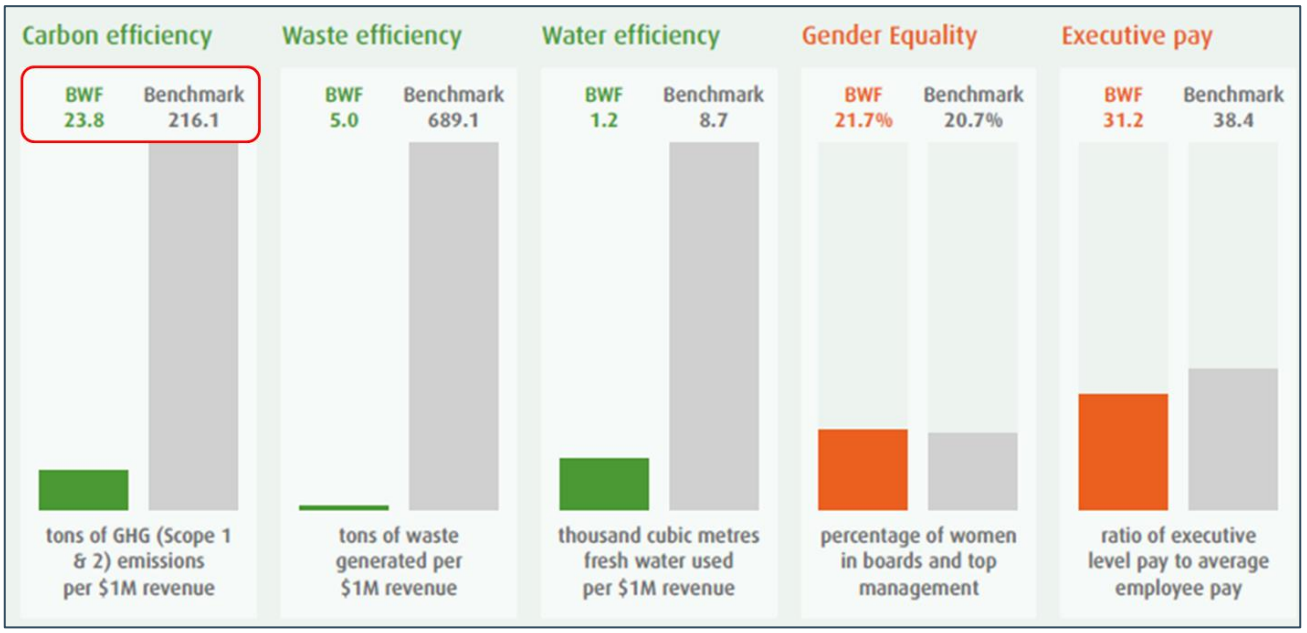
We publish an award-winning annual Impact Report detailing the progress of BWF from both an investment return and impact perspective. This is available on our website: https://montanaro.co.uk/fund/montanaro-better-world-fund/



The report includes independent analysis from Impact Cubed:



And carbon data:



Net zero carbon

Montanaro became a signatory to the Net Zero Asset Managers initiative ("NZAM") in 2021.

This followed two years of extensive engagement with our investee companies to understand how they were responding to climate change and the publication of our inaugural "Project: Net Zero Carbon" report. At the end of 2021 we published our second update to this project. Prior to signing up to NZAM, we also participated in a collaborative initiative with a small group of asset managers, launched in March 2019, which aimed to stimulate net zero carbon targets.

Our NZAM commitment is a natural step for us to take: the setting of explicit climate related targets across our investment portfolios that are measurable and quantifiable. We explain our proposed methodology below.

OUR NET ZERO METHODOLOGY:

Proportion of AUM to be managed in line with net zero:
Our NZAM target covers 70% of our assets under management (£2.8 billion at 31 March 2022). Our target covers Montanaro's open ended funds (both Ireland and UK domiciled). We are working with the asset owners of our segregated accounts to understand their own approaches to net zero carbon. We also manage two Investment Trusts and a net zero carbon committed is something that is being discussed by the respective Investment Trust Boards.

Montanaro manages listed equity portfolios only. Our specific allocation to "Climate Solutions" comes via our impact strategy, the Better World Fund. The Fund utilises themes to select companies that are contributing to environmental and societal solutions. Two of these themes relate to the environment: Environmental Protection and Green Economy. Allocation to companies contributing to these themes is currently 36%.

Selected reporting frameworks:

- PAII Net Zero Investment Framework: used to set an annual 7% emissions reduction target across our portfolios. The 7% annual reduction target will apply across each of our in scope portfolios. The 7% emission reduction year-on-year target is derived from the P2 model in the IPCC special report on global warming and aligned to a 1.5°C scenario (and a 50% reduction in emissions by 2030).
- Science Based Target initiative (SBTi) for Financial Institutions: 50% of the designated AUM will have implemented a Science Based Target by 2030 and 100% of AUM will be covered by 2040[6].
-

Baseline:
The baseline year for the reporting frameworks is 2019. Target metrics are:

- Financed emissions (scopes 1&2) - xxtCO2/$ invested
- % of companies with SBT targets

[6] SBTs are recognised when a target is set, rather than when a commitment to set a SBT is made. Under SBTi, you need SBT targets in place by 2040 in order for companies to be Net Zero by 2050.

Scope emissions coverage:
The targets cover Scope 1 and 2 emissions and aims to include Scope 3 once data is sufficiently available. Data disclosure continues to be an issue in our Small & MidCap markets.

Fossil fuel exposure:
MAM does not invest directly in fossil fuel companies across any of its investment portfolios (100% of AUM).

Physical climate risk:
Physical climate risk is appraised in our investment analysis. We use MSCI and company sourced data to measure the environmental intensity of our companies across carbon, water and waste. Where available, we record the carbon intensity of companies across Scopes 1, 2 and 3 based on tonnes of carbon used per million US Dollars of sales generated. We do the same for water and waste. This allows us to compare the carbon intensity of companies across our Approved List as well as within a given sector or Portfolio.

In addition to the above, we also record two MSCI scores related to how well companies are managing the transition to a low carbon economy:

Low Carbon Transition Management: this indicator measures how well a company manages risk and opportunities related to the Low Carbon Transition. It combines Management assessments for the following key issues: Carbon Emission for all companies; Product Carbon Footprint; Financing Environmental Impact; Opportunities in Clean Tech; and Opportunities in Renewable Energy where available. Higher scores (on a scale of 0-10) indicate a greater capacity to manage risk.

Low Carbon Transition Score: this is a company level score that measures a company's level of alignment to the Low Carbon Transition. Companies with higher Low Carbon Transition scores (on a scale of 0 - 10) are more aligned with the Low Carbon Transition compared to the companies with lower scores.

We assess environmental management culture (in accordance with UN Global Compact Principles 7-9); supply chain management; and the extent to which a company's products/services are a positive influence on the environment. We also record whether a company's operations are certified by a national or global standard (e.g. ISO 14001).

Finally, we consider the quality of a company's environmental reporting and if they have a Net Zero Carbon target or other environmental targets in place.

Engagement:
We are in the third year of conducting a long-term "Net Zero Engagement Project" where we contact companies from across our approved list to encourage better disclosure and ambitious target setting with regard to climate change. We advocate for investee companies to commit to Science Based Targets and report against recognised frameworks such as CDP and TCFD. Our Net Zero Carbon engagement reports can be viewed here:

- 2020
- 2021

Engagement

As responsible shareholders we believe that it is our duty to engage with our investee companies where necessary. In our experience, active engagement can help to foster positive long-term change in the way businesses are run and potentially lead to better investment returns and improved societal and environmental outcomes.

Engagement forms a key part of our long-term approach, allowing us to identify and manage risks within our portfolios, fulfil our stewardship responsibilities and consider other stakeholders (a duty of all B Corps). Engagement is used as a tool to better understand a company's impact, leading to better investment decisions.

Engagement is important to our investment approach. It allows us to deliver on client needs, our purpose and investment beliefs.

Engagement is typically initiated and conducted by our Analysts as they hold the closest relationships with company management. Support is provided by the Head of Sustainable Investment and our ESG & Impact Specialist, who may lead certain cases, such as those involving multiple stakeholders, collaborative engagements, or those that affect a number of companies within a portfolio. Our internal Sustainability Committee review engagement activity at quarterly meetings. The Committee will commission "Deep Dive" projects should they feel there is a necessity for a thorough review of a particular topic and how it effects a number of our holdings.

Our stewardship and engagement activity typically falls into one of the following categories:

1) **Direct Company Engagements:** a company-specific risk or issue has been identified on which we wish to engage. This may include an area of weakness identified in our ESG analysis or where we become aware of an incident or breach of our ESG policies or international norms (e.g. the UN Global Compact). In the main, we consider this type of engagement to be "reactive" as we are responding to a particular event although we may also conduct fact finds on a company-specific basis.
2) **Proxy Voting:** Voting is a vital part of our engagement with companies. This is why we attempt to vote at all Annual General Meetings for holdings within our Funds. We receive independent third-party corporate governance reports and voting recommendations from Institutional Investor Services (ISS) ahead of meetings, however we use these for advice only; our Analysts systematically review all resolutions ahead of shareholder meetings and we voice our concerns where required. We aim to discuss any issues with management prior to voting against or abstaining. Our decisions are guided by our proprietary voting guidelines which can be found here.
3) **Deep Dive Research:** we conduct thematic "Deep Dive" engagement projects on specific subjects to better understand how our companies are exposed to a particular issue or area of risk. We consider this type of engagement to be "proactive" as we are taking steps to understand more about a particular subject and the exposure of our investee companies to that risk before it can manifest.
4) **Collaborative Engagements:** We seek out collaborative engagement projects that offer a material benefit to the achievement of engagement aims. These projects can add additional

support and aid in the promotion of sustainable investment practice.

5) **Public Policy Advocacy:** We are involved with groups that advocate for responsible stakeholder capitalism. These include the Glasgow Financial Alliance for Net Zero (GFANZ) and the B Corp Finance & Investment working group.

These approaches have been chosen because they are efficient; amplify our voice; and ensure that we stay abreast of changing market conditions. By carefully targeting our engagement efforts we are able to effect change, despite the modest size of our organisation.

How we engage

There are a number of channels open to us when we seek to engage with a company. These include:

- Direct engagement with the management and /or Board;
- Speaking to industry competitors;
- Speaking with industry representatives such as Trade Unions;
- Liaising with other shareholders;

Engagement process

Our engagement process can be summarised as follows:

1. **Issue source:** we can become aware of issues that require engagement through a number of sources. Our Ethical & ESG Checklists are a primary source as they force our Analysts to "score" a company on Ethical & ESG grounds. A low score in a particular area often suggests that engagement of some kind is needed. Company meetings and site visits also provide us with an opportunity to discover whether an issue exists that requires engagement. In addition to this we also monitor company newsflow, through the information provider Factiva as well as more mainstream news sources.

2. **Deciding to engage:** if an Analyst (or any other member of Montanaro's staff) feels that engagement is needed with a company, the relevant Analyst will discuss the issue with the Sustainability Committee at an ad hoc meeting, or via email. They will agree on which of the Engagement Channels to pursue given the case details and the Analyst will then go ahead and engage.

3. **Recording engagement:** all engagement activity is recorded on Montanaro's ESG Engagement Log. Any activity is deemed to be "ongoing" until formally closed. It is the responsibility of the Sustainability Committee to review this Log at each meeting to monitor progress and discuss priorities.

4. **Monitoring engagement:** once we have initiated engagement with a company the Analyst and Sustainability Committee – supported by other members of the Investment Team, such as the Head of Research – monitor the company's response. This can go a number of ways:
   - The company responds promptly and assuages our concerns and/or provides material evidence to prove that they are going to solve the issue at hand.
   - The company responds promptly but we are not satisfied by their answer. We engage further. In some cases we may speak to competitors of the company to better understand the industry, or an industry body, such as a Trade Union or discuss the matter at a

shareholders forum.

- The company does not respond, so our Analyst engages again with management. In some cases we may choose to escalate the matter to another member of the company's senior management team in an effort to garner a response.
- The company does not respond and appears unlikely to do so, so we liaise with industry bodies or other shareholders in order to gain further support for our cause, or better understand the situation.

5. **Reaching a conclusion:** in an ideal world we wish to reach a positive conclusion on every matter of engagement. Our single aim when we engage with companies is to encourage an improvement in behaviour that leads to more sustainable business practices. We are realistic, however; engagement is often a complex business in itself. We do not place a deadline on engagement as in our experience, complex issues can take time to resolve. As long-term shareholders, our focus is on ensuring the improvement of a company's performance over a long time period. However, if our engagement subsequently leads us to doubt the longer term attraction of an investment, that investment will be reviewed and could be sold.

Escalation

Escalation is applied consistently across all Montanaro Funds given our single asset class focus (100% Small & MidCap quoted equity).

We always attempt to engage constructively with the companies in which we invest. If we identify an issue that requires engagement, we will always speak to the company first. We recognise that engagement takes time and we are willing to speak to management teams a number of times in order to raise a concern and work with them to reach a solution. However, in instances where our concerns are not addressed or the company does not respond constructively to an engagement, we may decide to escalate the engagement to achieve our desired outcome.

Our escalation strategy falls into two parts:

- **Internal:** If an Analyst or another member of the team leading an engagement fails to get satisfactory answers to an engagement matter, then they will discuss the next steps with members of the Sustainability Committee. They will decide if further engagement is required and likely to be constructive. If we decide not to escalate the engagement further, then the Analyst will discuss the case with the Investment Committee and the Analyst may recommend that the stock be sold. If we decide further engagement is warranted, then we will proceed to step two.

- **External:** Escalation typically begins by escalating the engagement up the corporate hierarchy. For example, if our first point of contact has been the Head of Investor Relations, then we may ask to speak to a member of the Executive Team (typically the CEO or CFO). If they prove unresponsive, then we will seek to speak with members of the Board (such as the Chair or Chair of the Remuneration Committee). In the world of SmallCap, many companies remain majority-owned by the founder, or family members of the founder. We have experience of escalating matters with companies which have resulted in meetings with family shareholders who have not, or do not usually, meet with minority shareholders. In some instances we will also escalate matters more widely, either by speaking to industry bodies or other shareholders. In serious instances, we may indicate that we are withholding our support by abstaining or voting against

management. We may also consider calling an EGM. If the above steps do not allow us to realise the aims of the engagement, then we may choose to sell the shares.

ESG targets

In addition to our Fund's SFDR classifications (Article 8/9) certain MAM Funds have ESG targets. These targets influence the focus of our engagement activity and are a requirement of the "Label ISR":

Montanaro Better World Fund:

- Environmental: at least 20% of the companies within the Fund by value to have achieved "Net Zero Carbon" by 2030;
- Social: at least 30% of Women on Boards across the Fund by 2025;
- Governance: at least 75% of Independent Directors across the Fund by 2025;
- Human Rights: at least 70% of companies within the Fund reporting an Anti-Bribery Policy by 2025.

Montanaro European Smaller Companies Fund:

- Environmental: at least a 20% reduction in carbon intensity (Scope 1 & 2) by 2025;
- Social: at least 40% of Women on Boards across the Fund by 2025;
- Governance: at least 70% of Independent Directors across the Fund by 2025;
- Human Rights: at least 70% of companies within the Fund reporting an Anti-Bribery Policy by 2025.

Voting

Voting is a vital part of our how we exercise our stewardship responsibilities. It is a key shareholder responsibility which is why we vote at all AGMs.

We receive independent third-party corporate governance reports and voting recommendations from Institutional Investor Services (ISS) ahead of meetings. These are used for advice only. Our Analysts systematically review all resolutions ahead of shareholder meetings and we voice our concerns where required. We aim to discuss any issues with management prior to voting against or abstaining. As such, we consider ourselves as "active" shareholders rather than "activists".

Our voting policy is applied consistently across all our Funds and Investment Trusts. Our policy is applied to segregated portfolios where we have authority to vote on our clients' behalf. If we do not have authority to vote for segregated mandates, we still share our view with our clients. We do not engage in stock lending in any of our Funds (although our segregated clients may have their own policies on this).

Our Voting Policy can be summarised by the following points:

- We seek to exercise all of our voting rights.
- We make our own voting decisions.
- We do not chose to automatically support the Board or the Executive of an investee company.
- We have and will abstain or vote against resolutions.
- We publish Voting Activity Summary Reports on our website.

We make our own voting decisions

We receive independent third-party corporate governance reports and voting recommendations from Institutional Investor Services (ISS) ahead of meetings, however we use these for advice only. Our Analysts systematically review all resolutions ahead of shareholder meetings and we voice our concerns where required. Via dialogue with the Investment and Sustainability Committees, our Analysts aim to discuss any issues with management prior to voting against or abstaining.

We apply the same voting decisions across all portfolios, unless a segregated client has specified that a particular voting policy be applied in their client agreement. We keep a record of our voting rationale.

We publish voting activity summary reports on our website

We use ISS to process our proxy voting. All voting activity is recorded in our Proxy Voting Log. The Sustainability Committee reviews voting activity for the quarter at each meeting. Voting Activity Summaries are produced quarterly and published on our website. These include the total number of proposals we voted on and a breakdown of how we voted on different subjects such as approving Remuneration policies, electing Directors and approving capital increases.

Our annual voting records can be found in our ESG Library at: https://montanaro.co.uk/sustainable-investing/

UK Stewardship Code

The UK Stewardship Code 2020 ("the Code") set higher standards for those investing on behalf of UK savers and pensioners. The greater level of transparency required by the Code and its focus on reported outcomes is, we believe, of great support to the development of a sustainable financial system that works for the benefit of all stakeholders.

Montanaro has been a signatory to the UK Stewardship Code since its inception in 2010. Our 2016 statement was ranked a Tier 1 submission. Last year, we were pleased to have been listed as a first wave signatory to the revised 2020 iteration of the Code.

At MAM, we define "Stewardship" as the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society. It is a responsibility that we take very seriously and underpins everything that we do.

Our annual statement can be found on our website: https://montanaro.co.uk/sustainable-investing/

Signatory of:

STEWARDSHIP CODE | 2021

Data and service providers

The following companies provide services to Montanaro. Each is reviewed as explained below:

ISS

We receive independent corporate governance reports and voting recommendations from Institutional Investor Services (ISS) ahead of votable meetings. We use these for advice only and review every ISS voting recommendation before we submit our vote.

Review: Annual review is led by the Sustainability Committee. We review voting records to ensure that votes have been cast according to our policies and stated preferences (in instances where we have decided to vote against the ISS recommendation). We also arrange annual meetings with ISS to discuss their service offering to ensure that it remains cost-effective and we are utilising the full range of their services. Over the course of 2021, we found that the research notes from ISS have been detailed and informative. They are excellent at providing updates on company management and the governance structures in place at our investee companies. The voting suggestions are well-reasoned and, even where we choose not to vote in line with the ISS recommendations, their recommendations offer valuable points of discussion both internally in order to reach a voting decision and as topics for engagement with the companies in question. With this in mind, we remain satisfied with the service that ISS deliver and will continue to subscribe to the platform in 2022 and review the provision annually.

MSCI

We continued to receive carbon related data on the companies in the MSCI World SMidCap Index from MSCI, which is provided to us on a quarterly basis. This data is incorporated into our ESG Checklists, allowing us to better understand the ESG profile of the businesses in which we invest. A change in 2021 was that we broadened the scope of our relationship with MSCI and began to receive MSCI ESG Ratings for the companies in the above index, including additional ESG metrics. MSCI's ESG ratings are used to compare and contrast with the conclusions of our ESG Checklists.

Review: Annual review is led by the Sustainability Committee. We were able to implement our new ESG checklists during the year and found that the ESG data points received from MSCI were particularly useful for this exercise. As a result, we opted to expand our subscription to MSCI services in order to facilitate access to their ESG manager platform. Thus far we have found the features offered on the platform useful. A full review of this additional service will be initiated next year. However, it is important to note that we continue to rely on our own ESG Checklists rather than the MSCI ratings in order to inform our investment decisions.

Bloomberg

We source company level ESG data from Bloomberg which is incorporated into our ESG Checklists (although some of this data is being phased out in favour of MSCI data as we wish to use a single data source where possible).

Review: Annual review is led by the Head of Fund Management covering the entire scope of the

Bloomberg offering, including the data and content used for performance and company analysis. From an ESG perspective, Bloomberg helps us to monitor the level of disclosure and transparency offered by our investee companies. This in turn influences company engagement as appropriately detailed company reporting is an important issue for investors.

Factiva

Global news monitoring and search engine Factiva allows us to monitor company newsflow and identify news stories related to our companies that we may otherwise not see by simply focusing on mainstream news sources. We use this primarily as a tool to help us identify issues on which engagement may be required.

Review: Annual review is led by the Sustainability Committee. As with last year, a challenge of this offering is that it can highlight information that is not particularly current. An old news story is not useful as the opportunity to have engaged with management may have passed. To better utilise this system, it has been brought under the responsibility of our ESG & Impact Specialist.

Impact Cubed

After a long search which included a detailed review of 5 different providers, our Sustainability Committee appointed Impact Cubed to aid our impact reporting. The aim of this appointment was to get the impact credentials of the Fund externally verified and assessed.

Review: Annual review is led by the Sustainability Committee. Impact Cubed offer an independent factor assessment of the Fund versus 14 sustainability measures and quantify the active sustainability exposures versus the Fund's benchmark. Due to the positive feedback received from readers and our review of the work undertaken by Impact Cubed, we have opted to continue the use of their services for 2022.

Becoming a B Corporation

Certified B Corporations ("B Corps") are defined as for-profit companies that use the power of business to build a more inclusive and sustainable economy.

B Corporations meet the highest verified standards of social and environmental performance, transparency and accountability. In addition:

- Certified B Corporations amend their governance so that, by law, they can make decisions and implement practices that consider not just shareholder value, but the impact on all stakeholders: employees, customers, society, and the environment.
- B Corp Certification is a highly selective status. Companies must document their positive impact to qualify and undergo verification every three years to maintain their Certification.
- Certified B Corporations range from multinational corporations [Natura] to wholly owned subsidiaries [Seventh Generation] to small businesses [Harvest Market] serving local communities.
- It is one of the only certifications that is not for a product or service but for the whole business behind the product or service.
- B Corporation Certification helps consumers identify companies with a mission and helps investors to select investments that align with their values.

Becoming a B Corp was a natural step in Montanaro's Responsible Investment journey.

The Certification process uses credible, comprehensive, transparent and independent standards of social and environmental performance. The B Corp assessment process measures a company's performance in five categories:

1. Governance;
2. Workers;
3. Customers;
4. Community;
5. the Environment.

The assessment is marked out of 200 and the pass mark to become a B Corp is 80. The median score for businesses who complete the impact assessment is 50.9.

Sustainability at MAM

One of our core values is to "Practice what we preach". As a certified B Corporation, we apply the same sustainability standards to our business as we expect from our investee companies.

Net zero carbon: operations

At the UN Climate Change Conference (COP 25) in Madrid in December 2019, MAM joined fellow B Corporations to publicly commit to achieving Net Zero Carbon across our operations by 2030, some 20 years ahead of the 2050 targets set in the Paris Agreement.

While our footprint is small, it is important to demonstrate leadership and practice what we are preaching to our investee companies.

Since then, we have been working with Environmental Consultant Green Element to measure our carbon footprint and identify carbon reduction opportunities.

One early success has been the transfer of our office to a renewable energy contract, no mean feat given we had to win the agreement of larger multinational companies who exist in our block. This shows that although we are a small business, we can have a wide impact.

Updates to our operational net zero carbon transition will be included in the Better World Fund annual impact report which is available on our website. Our net zero commitments are coordinated by our "Net Zero Steering Group" which is chaired by our Head of Sustainable Investment. The group meets on an ad-hoc basis and reports formerly into quarterly meetings on MAM's Sustainability Committee.

Sustainable office

Our team is multi-cultural and comprises over ten different nationalities. We promote diversity, equality and sustainability throughout our business.

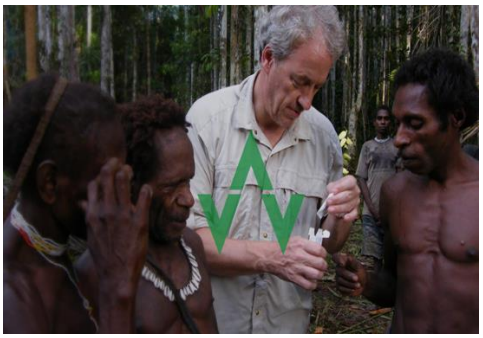
Our team is fully committed to doing their part to help MAM meet its sustainable objectives and reduce our environmental footprint. Since 2019, we have run recycling projects and energy saving initiatives internally. The team also play an important role in supporting MAM's various charity initiatives.

Charities

MAM supports a number of charity partners.

MAM is a major donor to **City Harvest**. The charity collects high quality surplus food from the UK's leading retailers, wholesalers, restaurants and manufacturers to distribute to more than 350 community programmes that serve meals to vulnerable people in London.

Montanaro founded and supports **Tribal Survival**, a UK registered charity, which aims to promote the well-being of indigenous people across the world. Each year, Charles and a team of doctors takes medical aid to remote tribes, including the Korowai in West Papua, a trip that was supported by the World Health Organisation.



Montanaro has become a major donor to **Rewilding Britain**, aiding the charity as it contributes to a national goal to restore 30% of UK land and sea by 2030. We will be the anchor partner as the Dorset Wildlife Trust rewets the headwaters of the River Sherford, in Dorset. The project will liberate the river from highly artificial channels and create between 30-40 hectares of wildlife rich wet land, store carbon in wetter soils, clean the water of agricultural diffuse pollution and alleviate flooding downstream.

Appendix

What does research say about ESG?

Appraising investment opportunities consistently from an ESG perspective can prove problematic. The reason for this is because, as Professors Elroy Dimson, Paul Marsh and Mike Staunton acknowledge[7], it can be hard to find a definition of an "unethical" company that is universally acceptable.

For instance, Medtronic, a medical devices company, is a constituent of the FTSE4Good Index but has a tax-inversion scheme that has been deemed unethical by certain stakeholders. The US supermarket, Walmart, scores highly on certain ESG metrics, but was divested by the Norwegian Sovereign Wealth Fund due to unacceptable labour practices.

Yet, when things go wrong, ESG failings are often highly visible. In recent years we have witnessed the unethical behaviour of the banking sector which contributed to the Global Financial Crisis; the environmental failings of BP after the Macondo oil disaster; and Tokyo Electric Power Company's social neglect, in the wake of Japan's Tsunami disaster. In all cases, shareholders and their fellow stakeholders suffered.

While ethical failings can appear obvious in hindsight, a problem for proponents of ESG investing is that there is no simple "forward-looking" way of evaluating ESG risk. Yet such difficulties should not preclude ESG from forming part of an investment process. In fact, there is academic support for such an approach:

- It is becoming increasingly difficult for investment decision-makers to dismiss ESG, given investors ***"readily quantify business goodwill and other equivalently nebulous intangibles"[8].***

- Responsible investing ***"recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well-governed social, environmental and economic systems"[9].***

- Considering ESG issues helps to protect all stakeholders, as ***"shareholders…can exercise considerable influence over the management of companies"[10].***

- Sustainability policies are a means of ***"pre-emptive insurance for adverse ESG events"[11].***

- Worthwhile ESG policies require ***"knowledge of the subject matter and criteria used to measure it"[12].***

We would suggest that there is no definitive proof that ESG increases shareholder returns. We would argue, however, that correctly integrated into an investment process, considering ESG makes positive investment returns more likely, rather than less. With this in mind, we would agree with the following

[7] Credit Suisse Global Investment Returns Yearbook 2015, Responsible investing: does it pay to be bad? Elroy Dimson, Paul Marsh and Mike Staunton, London Business School, pg. 20
[8] Ibid
[9] http://unpri.org/wp-content/uploads/1.Whatisresponsibleinvestment.pdf
[10] http://ec.europa.eu/environment/archives/finserv/fisum.pdf
[11] http://www.smithschool.ox.ac.uk/library/reports/SSEE_Arabesque_Paper_16Sept14.pdf
[12] http://www2.deloitte.com/content/dam/Deloitte/us/Documents/risk/us-aers-sustainability-reporting-landscape.pdf

statements:

- ESG *"considerations often have a role to play in the proper analysis of investment value"*[13].

- *"Socially and environmentally responsible policies…[minimise] risks by anticipating and preventing crises that can affect reputation and cause dramatic drops in share prices"*[14].

- *"Stock price performance is positively influenced by good sustainability practices"*[15].

- *"Sound sustainability standards lower the cost of capital of companies"*[16].

- *"Solid ESG practices result in better operational performance"*[17].

- *"Corporate engagement can pay, whether the focus is on environmental and social issues or on corporate governance"*[18].

In addition to the above, it is worth highlighting certain findings from a comprehensive report by Deutsche Bank, Sustainable Investing, Establishing Long-Term Value and Performance, 2012[19]. The report clearly demonstrates that there is academic support for considering ESG factors in investment decisions. Indeed, as the renowned economist Michael Jensen states, "it is obvious that we cannot maximise the long-term market value of an organisation if we ignore or mistreat any important constituency"[20]. The Deutsche Bank report analyses the findings of "over 100 studies…[including] 56 research papers, as well as 2 literature reviews and 4 meta studies":

- *"100% of the academic studies agree that companies with high ratings for CSR and ESG factors have a lower cost of capital in terms of debt (loans and bonds) and equity. In effect, the market recognises that these companies are lower risk than other companies and rewards them accordingly".*

- *"89% of the studies we examined show that companies with high ratings for ESG factors exhibit market-based outperformance, while 85% of the studies show these types of company's exhibit accounting-based outperformance".*

- *"The single most important of these factors, and the most looked at by academics to date, is Governance (G), with 20 studies focusing in on this component of ESG (relative to 10 studies focusing on E and 8 studies on S). In other words, any company that thinks it does not need to bother with improving its systems of corporate governance is, in effect, thumbing its nose at the market and hurting its own performance all at the same time".*

- *"Strong corporate commitment to ESG (or E, S or G) is positively correlated to a lower cost of capital. Again, this finding is evident in all the studies we analysed".*

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[13] *Credit Suisse Global Investment Returns Yearbook 2015*, *Responsible investing: does it pay to be bad?* Elroy Dimson, Paul Marsh and Mike Staunton, London Business School, pg. 20
[14] *The Commission Green Paper on promoting a European framework for Corporate Social Responsibility* COM (2001) 366 final (18/07/2001).
[15] http://www.smithschool.ox.ac.uk/library/reports/SSEE_Arabesque_Paper_16Sept14.pdf
[16] Ibid
[17] Ibid
[18] http://www.oekom-research.com/homepage/english/oekom_CR_Review_2013_en.pdf
[19] https://institutional.deutscheawm.com/content/_media/Sustainable_Investing_2012.pdf
[20] As cited in *Drivers of Long-Term Business Value: Stakeholders, stats and strategy*, Koehler & Henspenide, Deloitte, 2012

ESG library

Deep Dive Engagement reports:

- Project Net Zero Carbon 2021
- Project Net Zero Carbon 2020
- Data Centres Project
- The Biomass Debate
- Plastics Fantastic: Biffa Site Visit
- Supply Chain Investigation

UN PRI reports:

- 2020
- 2019
- 2018
- 2017

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Glossary

Key terms used in the Field of Sustainable Investing[21] :

Concept	Definition	Source
Ethical Investment	Investment philosophy guided by moral values, ethical codes or religious beliefs. Investment decisions include non-economic criteria. This practice has traditionally been associated with negative (or exclusionary) screening.	Mercer, 2007
Values-Driven Screening	Values-based (also referred to as negative or exclusionary) screening is defined as an investment approach that excludes some companies or sectors from the investment universe based on criteria relating to their policies, actions products or services. Investments that do not meet the minimum standards of the screen are not included in the investment portfolio. Criteria may include environmental, social, corporate governance or ethical issues. For example, specific industries or sectors such as weapons manufacturers, or specific companies considered to be poor environmental, social or governance (ESG) executors.	Mercer, 2007
Socially Responsible Investment (SRI)	SRI, as it first emerged, was very similar to ethical investing in that it allowed a level of trade-off between corporate social and financial performance when making investment decisions, and predominantly utilized exclusionary screening. However, modern SRI represents an investment process that seeks to achieve social and environmental objectives alongside financial objectives, utilizing both values-driven, and risk and return screening.	DBCCA analysis 2012; Mercer, 2007
Sustainability	Sustainability or sustainable development refers to the concept of meeting present needs without compromising the ability of future generations to meet their needs. It encompasses social welfare, protection of the environment, efficient use of natural resources and economic well-being.	Brundtland Report, 1987; Mercer, 2007
Risk & Return Screening	Risk and return (or positive) screening is defined as an investment approach that includes non-traditional criteria relating to the policies, actions, products or services of securities issuers. Portfolios are tilted towards stocks that rate well on the nominated criteria, which can include ESG or ethical issues.	Mercer, 2007
Corporate Governance	Procedures and/or processes according to which an organization is directed and controlled. Corporate Governance structure specifies the distribution of rights and responsibilities among the different participants in the organization – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision making. National and international best practice standards exist.	OECD, as cited in Mercer, 2007
Universal Owner	A large asset owner who, as a consequence of its size, owns a slice of the whole economy and market through its portfolios. Universal owners adapt their actions with the intent of improving long-term performance by benefiting the whole economy and market in a logical but ambitious extension of sustainable investing. They justify these actions on financial grounds.	Towers Watson, 2011
Environmental, Social and Corporate Governance (ESG)	The term that has emerged globally to describe the environmental, social and corporate governance issues that investors are considering in the context of corporate behavior. No definitive list of ESG issues exists, but they typically display one or more of the following characteristics: (i) issues that have traditionally been considered non-financial or not material; (ii) a medium or long-term time horizon; (iii) qualitative objectives that are not readily quantifiable in monetary terms; (iv) externalities not well captured by market mechanisms; (v) a changing regulatory or policy framework; (vi) patterns arising throughout a company's supply chain; and (vii) a public-concern focus.	Mercer, 2007
Best-in-Class Approach	Investment approach that focuses on companies that have historically performed better than their peers within a particular industry or sector on measures of environmental, social and corporate governance issues. This typically involves positive or negative screening or portfolio tilting.	Mercer, 2007
Responsible Investment	The integration of ESG considerations into investment management processes and ownership practices in the belief that these factors can have an impact on financial performance, in particular over the medium to longer-term. Responsible Investing (RI) can be practiced across all asset classes.	Mercer, 2007; DBCCA analysis

[21] https://institutional.deutscheawm.com/content/_media/Sustainable_Investing_2012.pdf

Key terms related to Corporate Social Responsibility and Shareholder Engagement[22]:

Concept Name	Definition	Source
Corporate Social Responsibility	Approach to business which takes into account economic, social, environmental and ethical impacts for a variety of reasons, including mitigating risk, decreasing costs, and improving brand image and competitiveness. This approach is sometimes implemented by means of a comprehensive set of policies and procedures integrated throughout a company, encompassing a wide range of practices, including: corporate governance, employee relations, supply chain relationships, customer relationships, environmental management, philanthropy and community involvement.	Mercer, 2007
Stakeholder	Individuals or organizations with an interest in the actions and impacts of an organization. They may be customers, suppliers, shareholders, employees, communities, members of special interest groups, non-governmental organizations, or regulators.	Mercer, 2007
Active Ownership	The voting of company shares and/or the engaging of corporate managers and boards of directors in dialogue on ESG issues as well as on business strategy issues. Increasingly pursued in an effort to reduce risk and enhance shareholder value. Can also be referred to as "Shareholder Activism".	Mercer, 2007
Shareholder Engagement	The practice of monitoring corporate behavior and seeking changes where appropriate through dialogue with companies or through the use of share ownership rights, such as filing shareholder resolutions. Shareholder engagement is often employed in attempts to improve a company's ESG performance.	Mercer, 2007
Proxy Voting	The delegation of voting rights from entitled voters who do not attend shareholders' meetings to delegates who vote on their behalf. Proxy voting allows shareholders to exercise their right to vote without committing the time involved in actually attending meetings. Proxy voting policies can include specific guidance on ESG and ethical decisions.	Mercer, 2007
Corporate Social Performance	A business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programs, and observable outcomes as they relate to the firm's societal relationships.	Wood, 1991:693[23]
Corporate Financial Performance	A term widely used within academia to refer to the financial or economic performance of a company. In general, academic studies have tended to focus on either financial accounting measures (for example, Return on Assets or Return on Equity) or economic measures (usually a company's stock performance) to measure, rank and compare the CFP of different companies.	DBCCA analysis 2012
Corporate Citizenship	A term used to describe a company's role in, or responsibilities towards society. For this reason it is sometimes used interchangeably with corporate social responsibility, although this concept is extended by some to refer to the political activities – and perhaps even rights – of a company.	DBCCA analysis 2012
Integrated Reporting	A growing practice of corporate reporting that demonstrates the linkage between an organization's financial performance in relation to environmental, social, and governance (ESG) factors that underlie the organization's core activities. By "integrating" financial and non-financial data, Integrated Reporting can help businesses take more sustainable decisions and enable investors and other stakeholders to transparently understand an organizations true performance.	DBCCA analysis 2012
Triple Bottom Line	A holistic approach to measuring a company's performance on environmental, social and economic issues. The triple bottom line focuses companies not just on the economic value they add, but also on the environmental and social value they add or destroy. This concept is frequently utilized in CSR or sustainability reporting.	Mercer, 2007; DBCCA analysis 2012

[22] https://institutional.deutscheawm.com/content/_media/Sustainable_Investing_2012.pdf

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